

have owned their FD stock since it was incorporated, and FD has always been a CFC. USS1 and USS2 each have a basis of \$500 in their FD stock, and the fair market value of each block of FD stock is \$750. FD owns 100 percent of the outstanding stock of FC, a foreign corporation. FD owned the stock since FC was incorporated. Neither FD nor FC own stock in any other corporation. FD has earnings and profits of \$0 and a fair market value of \$750 (not considering its ownership of FC). FC has earnings and profits of \$500, none of which is described in section 1248(d), and a fair market value of \$750. In a non-pro rata distribution described in section 355, FD distributes all of the stock of FC to USS2 in exchange for USS2's FD stock.

(ii) *Result*—(A) FD's distribution is a transaction described in paragraph (d)(1) of this section. Under paragraph (d)(2) of this section, USS1 is considered a distributee of FD stock. Under paragraph (d)(3) of this section, USS1 and USS2 must compare their predistribution amounts with respect to FD and FC stock to their respective postdistribution amounts. Under paragraph (e)(1) of this section, USS1's predistribution amount with respect to FD or FC is USS1's section 1248 amount computed immediately before the distribution, but only to the extent such amount is attributable to FD or FC. USS2's predistribution amount is determined in the same manner. Under § 1.367(b)-2(c)(1), USS1 and USS2 each have a section 1248 amount computed immediately before the distribution of \$250, all of which is attributable to FC. Thus, USS1 and USS2 each have a predistribution amount with respect to FD of \$0, and each have a predistribution amount with respect to FC of \$250. These amounts are computed as follows: If either USS1 or USS2 had sold its FD stock immediately before the transaction, it would have recognized \$250 of gain (\$750 fair market value—\$500 basis). All of the gain would have been treated as a dividend under section 1248, and all of the section 1248 amount would have been attributable to FC (based on USS1's and USS2's pro rata shares of FC's earnings and profits (50 percent × \$500)).

(B) Under paragraph (d)(3) of this section, a distributee that owns no stock in the distributing or controlled corporation immediately after the distribution has a postdistribution amount with regard to that stock of zero. Accordingly, USS2 has a postdistribution amount of \$0 with respect to FD and USS1 has a postdistribution amount of \$0 with respect to FC. Under paragraph (e)(2) of this section, USS1's postdistribution amount with respect to FD is its section 1248 amount with respect to such corporation, computed immediately after the distribution (but without regard to paragraph (d) of this section). USS2's postdistribution amount with respect to FC is determined in the same manner. Under § 1.367(b)-2(c)(1), USS1's sec-

tion 1248 amount computed immediately after the distribution with respect to FD is \$0 and USS2's section 1248 amount computed immediately after the distribution with respect to FC is \$250. These amounts, which are USS1's and USS2's postdistribution amounts, are computed as follows: After the non-pro rata distribution, USS1 owns all the stock of FD and USS2 owns all the stock of FC. If USS1 sold its FD stock immediately after the distribution, none of the resulting \$250 gain (\$750 fair market value \$500 basis) would be treated as a dividend under section 1248. If USS2 sold its FC stock immediately after the distribution, it would have a \$250 gain (\$750 fair market value—\$500 basis), all of which would be treated as a dividend under section 1248.

(C) The income inclusion rule of paragraph (d)(3) of this section applies to the extent of any difference between USS1's and USS2's postdistribution and predistribution amounts. In the case of USS2, there is no difference between the two amounts with respect to either FD or FC and, as a result, no income inclusion is required. In the case of USS1, there is no difference between the two amounts with respect to its FD stock. However, USS1's postdistribution amount with respect to FC is \$250 less than its predistribution amount. Accordingly, under paragraph (d)(3) of this section, USS1 is required to include \$250 in income as a deemed dividend. Under § 1.367(b)-2(e)(2), the \$250 deemed dividend is considered as having been paid by FC to FD, and by FD to USS1, immediately prior to the distribution. This deemed dividend increases USS1's basis in FD (\$500 + \$250 = \$750). Under paragraph (f) of this section, the deemed dividend is not included by FD as foreign personal holding company income under section 954(c).

[T.D. 8862, 65 FR 3606, Jan. 24, 2000; 65 FR 66502, Nov. 6, 2000]

§ 1.367(b)-6 Effective dates and coordination rules.

(a) *Effective date*—(1) *In general*. Except as otherwise provided in this paragraph (a)(1), §§ 1.367(b)-1 through 1.367(b)-5, and this section, apply to section 367(b) exchanges that occur on or after February 23, 2000. The rules of §§ 1.367(b)-3 and 1.367(b)-4, as they apply to reorganizations described in section 368(a)(1)(A) (including reorganizations described in section 368(a)(2)(D) or (E)) involving a foreign acquiring or foreign acquired corporation, apply only to transfers occurring on or after January 23, 2006. Section 1.367(b)-4(b)(1)(ii) applies to all triangular reorganizations and reorganizations described in section 368(a)(1)(G) and (a)(2)(D) occurring

§ 1.367(b)-6

26 CFR Ch. I (4-1-11 Edition)

on or after January 23, 2006, although taxpayers may apply § 1.367(b)-4(b)(1)(ii) to triangular B reorganizations occurring on or after February 23, 2000, in a taxable year that is not closed by the period of limitations if done consistently with respect to all such triangular B reorganizations. The second sentence of paragraph (a) in § 1.367(b)-4 shall apply to section 304(a)(1) transactions occurring on or after February 23, 2006; however, taxpayers may rely on this sentence for all section 304(a)(1) transactions occurring in open taxable years. Section 1.367(b)-1(c)(2)(v), (c)(3)(ii)(A), (c)(4)(iv), (c)(4)(v), 1.367(b)-2(j)(1)(i), (l), and 1.367(b)-3(e) and (f), apply to section 367(b) exchanges that occur on or after November 6, 2006. For guidance with respect to § 1.367(b)-1(c)(3)(ii)(A) and (c)(4)(iv) and (v) and § 1.367(b)-2(j)(1)(i) for exchanges that occur before November 6, 2006, see 26 CFR part 1 revised as of April 1, 2006.

(2) *Exception.* A taxpayer may, however, elect to have §§ 1.367(b)-1 through 1.367(b)-5, and this section, apply to section 367(b) exchanges that occur (or occurred) before February 23, 2000, if the due date for the taxpayer's timely filed Federal tax return (including extensions) for the taxable year in which the section 367(b) exchange occurs (or occurred) is after February 23, 2000. The election under this paragraph (a)(2) will be valid only if—

(i) The electing taxpayer makes the election on a timely filed section 367(b) notice;

(ii) In the case of an exchanging shareholder that is a foreign corporation, the election is made on the section 367(b) notice that is filed by each of its shareholders listed in § 1.367(b)-1(c)(3)(ii); and

(iii) The electing taxpayer provides notice of the election to all corporations (or their successors in interest) whose earnings and profits are affected by the election on or before the date the section 367(b) notice is filed.

(b) *Certain recapitalizations described in § 1.367(b)-4(b)(3).* In the case of a recapitalization described in § 1.367(b)-4(b)(3) that occurred prior to July 20, 1998, the exchanging shareholder shall include the section 1248 amount on its tax return for the taxable year that in-

cludes the exchange described in § 1.367(b)-4(b)(3)(i) (and not in the taxable year of the recapitalization), except that no inclusion is required if both the recapitalization and the exchange described in § 1.367(b)-4(b)(3)(i) occurred prior to July 20, 1998.

(c) *Use of reasonable method to comply with prior published guidance—*(1) *Prior exchanges.* The taxpayer may use a reasonable method to comply with the following prior published guidance to the extent such guidance relates to section 367(b): Notice 88-71 (1988-2 C.B. 374); Notice 89-30 (1989-1 C.B. 670); and Notice 89-79 (1989-2 C.B. 392) (see § 601.601(d)(2) of this chapter). This rule applies to section 367(b) exchanges that occur (or occurred) before February 23, 2000, or, if a taxpayer makes the election described in paragraph (a)(2) of this section, for section 367(b) exchanges that occur (or occurred) before the date described in paragraph (a)(2) of this section. This rule also applies to section 367(b) exchanges and distributions described in paragraph (d) of this section.

(2) *Future exchanges.* Section 367(b) exchanges that occur on or after February 23, 2000, (or, if a taxpayer makes the election described in paragraph (a)(2) of this section, for section 367(b) exchanges that occur on or after the date described in paragraph (a)(2) of this section) are governed by the section 367(b) regulations and, as a result, paragraph (c)(1) of this section shall not apply.

(d) *Effect of removal of attribution rules.* To the extent that the rules under §§ 7.367(b)-9 and 7.367(b)-10(h) of this chapter, as in effect prior to February 23, 2000 (see 26 CFR part 1, revised as of April 1, 1999), attributed earnings and profits to the stock of a foreign corporation in connection with an exchange described in section 351, 354, 355, or 356 before February 23, 2000, the foreign corporation shall continue to be subject to the rules of § 7.367(b)-12 of this chapter in the event of any subsequent exchanges and distributions with respect to such stock, notwithstanding the fact that such subsequent exchange or distribution occurs on or

after the effective date described in paragraph (a) of this section.

[T.D. 8862, 65 FR 3608, Jan. 24, 2000, as amended by T.D. 9243, 71 FR 4289, Jan. 26, 2006; T.D. 9250, 71 FR 8805, Feb. 21, 2006; T.D. 9243, 71 FR 28266, May 16, 2006; T.D. 9273, 71 FR 44895, Aug. 8, 2006; 73 FR 14386, Mar. 18, 2008]

§ 1.367(b)-7 Carryover of earnings and profits and foreign income taxes in certain foreign-to-foreign non-recognition transactions.

(a) *Scope.* This section applies to an acquisition by a foreign corporation (foreign acquiring corporation) of the assets of another foreign corporation (foreign target corporation) in a transaction described in section 381 (foreign section 381 transaction). This section describes the manner and extent to which earnings and profits and foreign income taxes of the foreign acquiring corporation and the foreign target corporation carry over to the surviving foreign corporation (foreign surviving corporation) and the ordering of distributions by the foreign surviving corporation. See § 1.367(b)-9 for special rules governing reorganizations described in section 368(a)(1)(F) and foreign section 381 transactions involving foreign corporations that hold no property and have no tax attributes immediately before the transaction, other than a nominal amount of assets (and related tax attributes).

(b) *General rules*—(1) *Non-previously taxed earnings and profits and related taxes.* Earnings and profits and related foreign income taxes of the foreign acquiring corporation and the foreign target corporation (pre-transaction earnings and pre-transaction taxes, respectively) shall carry over to the foreign surviving corporation in the manner described in paragraphs (d), (e), and (f) of this section. Dividend distributions by the foreign surviving corporation (post-transaction distributions) shall be out of earnings and profits and shall reduce related foreign income taxes in the manner described in paragraph (c) of this section.

(2) *Previously taxed earnings and profits.* [Reserved]

(c) *Ordering rule for post-transaction distributions.* Dividend distributions out of a foreign surviving corporation's earnings and profits shall be ordered in

accordance with the rules of paragraph (c)(1) or (2) of this section, depending on whether the foreign surviving corporation is a pooling corporation or a nonpooling corporation.

(1) *If foreign surviving corporation is a pooling corporation.* In the case of a foreign surviving corporation that is a pooling corporation, post-transaction distributions shall be first out of the post-1986 pool (as described in paragraph (d) of this section) and second out of the pre-pooling annual layers (as described in paragraph (e)(1) of this section) under an annual last-in, first-out (LIFO) method.

(2) *If foreign surviving corporation is a nonpooling corporation.* In the case of a foreign surviving corporation that is a nonpooling corporation, post-transaction distributions shall be out of the pre-pooling annual layers (as described in paragraph (e)(2) of this section) under the LIFO method.

(d) *Post-1986 pool.* If the foreign surviving corporation is a pooling corporation, then the post-1986 pool shall be determined under the rules of this paragraph (d).

(1) *In general*—(i) *Qualifying earnings and taxes.* The post-1986 pool shall consist of the post-1986 undistributed earnings and related post-1986 foreign income taxes of the foreign acquiring corporation and the foreign target corporation.

(ii) *Carryover rule.* Subject to paragraph (d)(2) of this section, the amounts described in paragraph (d)(1)(i) of this section attributable to the foreign acquiring corporation and the foreign target corporation shall carry over to the foreign surviving corporation and shall be combined on a separate category-by-separate category basis.

(2) *Hovering deficit*—(i) *In general.* If immediately prior to the foreign section 381 transaction either the foreign acquiring corporation or the foreign target corporation has a deficit in one or more separate categories of post-1986 undistributed earnings or an aggregate deficit in pre-1987 accumulated profits, such deficit will be a hovering deficit of the foreign surviving corporation. The rules of this paragraph (d)(2) apply